

Service Date: February 13, 2006

DEPARTMENT OF PUBLIC SERVICE REGULATION
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MONTANA

* * * * *

IN THE MATTER OF the Application of)	UTILITY DIVISION
NorthWestern Energy's for Automatic Rate)	
Adjustment and Tracking for Taxes and Fees)	DOCKET NO. D2005.12.170
)	Final Order No. 6716
)	

FINAL ORDER

History

1. On December 7, 2005, NorthWestern Energy (NWE) filed an Application for Interim and Final Rate Adjustment (Application) to increase certain rates and schedules due to increased Montana state and local taxes. NWE's proposed adjustments would increase electric transmission and distribution rates by 5.96% and natural gas delivery and storage rates by 5.82%.
2. On December 14, 2005, the Montana Public Service Commission (Commission) issued a Notice of Application, Determination of Error, Opportunity to Comment and to Request Hearing, and Provisional Notice of Public Hearing (Notice). The Commission determined that the rate schedules proposed by NWE were in error in that they did not properly include adjustments for the net change in federal and state income tax liability caused by the deductibility of state and local taxes and fees and did not appear to calculate the recoverable deferred balance of 2005 taxes correctly. The Notice also stated, "Notice of the [Commission's] determination with respect to the enumerated errors and omissions should not be considered to preclude determination of additional errors and omissions."
3. On December 23, 2005, NWE filed information showing the derivation of tariffs reflecting the adjustments for the net change in federal and state income tax liability caused by the deductibility of state and local taxes and fees, without waving its rights to challenge the legality of the Commission's Orders, and requested a hearing in the matter.
4. On December 29, 2005, the Montana Consumer Counsel (MCC) petitioned to intervene and filed comments in the docket.

5. On December 30, 2005, NWE filed tariffs adjusting its rates for the net change in federal and state income tax liability caused by the deductibility of state and local taxes and staff approved on an interim basis the tariffs filed by NWE. The adjustments automatically went into effect on an interim basis on January 1, 2006. § 69-8-302(2)(b), MCA. Failure of the Commission to, within 45 days of the filing date, order a public utility to address any errors or omissions is considered approval of the filing by operation of law. §69-3-308(2)(d), MCA. Forty-five days from the filing date in this docket was January 21, 2006. To the extent that § 69-3-308(2)(d) requires the Commission to issue a final order within 45 days of the filing date, NWE waived the statute for a 30-day period. Tr. at p. 36.

6. On January 5, 2006, the Commission held a hearing in this docket. NWE's responses to data requests PSC-001 through PSC-004 were entered into the record. Tr. at p.6. Exhibits NWE-1 (the Application) and NWE-2 (the pre-filed testimony of Kendall G. Kliever) were admitted into record. Tr. at p11-12. NWE waived the 45-day requirement for a final order date for a 30-day period.

7. NWE and MCC filed Initial Post-Hearing Briefs on January 13, 2006 and Response Briefs on January 23, 2006.

Discussion and Findings of Fact

8. The issues in this docket are threefold:

- a. What estimated 2006 taxes may be included in electric and natural gas rates;
- b. What uncollected 2005 taxes may be included in electric and natural gas rates;
and
- c. What adjustments, if any, should be made for taxes on transmission assets that are used in both intra and interstate commerce?

2005 Under-collection

9. In 2004, NWE estimated its 2005 state and local taxes to be \$41,093,769 for electric and \$14,840,563 for natural gas. NWE requested rates to collect an increase of \$685,422 for electric service and \$173,410 for natural gas service. After applying the marginal income tax rate adjustment, the Commission allowed increases of \$425,434 for electric and \$105,104 for natural gas. In this filing, NWE asserted that 2005 state and local taxes actually were \$48,077,097 for

electric and \$17,496,856 for natural gas. NWE requested authorization to collect a deferred balance of \$6,844,297 for electric and \$2,554,195 for natural gas. In calculating the deferred balance, NWE ignored the income tax adjustment that the Commission has required. The Commission calculates the deferred balances as shown in the table below:

2005 Actual Taxes	Electric	Natural Gas
Property	\$46,772,353	\$17,496,856
WET	\$1,304,744	
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Total	\$48,077,097	\$17,496,856
Collected @ 99 Rates	(\$40,927,224)	(\$14,638,941)
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Gross Adjustment	\$7,149,873	\$2,857,915
Income Tax Effect	(\$2,816,335)	(\$1,125,733)
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Allowed Adjustment	\$4,333,538	\$1,732,182
Incremental Collection	(\$301,147)	(\$205,127)
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2005 Under-collection	\$4,032,391	\$1,527,055

2006 Estimated Taxes

10. In the Application, NWE requested 2006 taxes of \$48,077,097 for electric and \$17,496,856 for natural gas. NWE based its estimate of 2006 taxes on actual taxes for 2005. NWE is allowed to collect state and local taxes and fees only directly related to regulated activities or on assets (or portion of assets) used and useful in providing regulated service to Montana ratepayers. The Commission determines that NWE requested inclusion of taxes that it did not substantiate and taxes or fees that are not within the statute.

11. The Commission compared NWE's presentation of the original cost of regulated and non-regulated assets for 2004 and 2005. According to NWE, the original cost of its regulated non-regulated assets decreased by \$63.5 million from 2004 to 2005 but the original cost of regulated assets increased by \$58.6 million. At the hearing, NWE's witness, Kendall G. Kliever stated that he could not explain the changes in original cost. Tr. at p. 18. Mr. Kliever also testified that there has been no significant new investment in Montana. Tr. at p. 21. Based on NWE's testimony and what appears to be an unexplained reclassification of non-regulated assets

to regulated assets between 2004 and 2005, the Commission determines the tax increase attributable to the increase in original cost between 2004 and 2005 should be disallowed. The Commission calculates the tax attributable to the incremental increase of taxes on regulated assets to be \$2,306,275 as outlined in the table below:

DESCRIPTION	05OC	04OC	DIFF	INC TAX	ELECTRIC	NATURAL GAS
Common Situs	83,512,231	81,637,271	1,874,960	\$85,736	\$57,169	\$28,567
Electric Distribution	617,844,234	588,549,022	29,295,212	\$1,180,295	\$1,180,295	
Fuel Expense	391,816	372,298	19,518	\$672	\$672	
Other Transmission	17,808,334	17,749,668	58,666	\$1,405	\$1,405	
Col-Bdvw 500 A&B	17,786,323	17,586,239	200,084	\$5,738	\$5,738	
Bdvw-Twnsnd 500 A&B	16,154,195	16,117,248	36,947	\$988	\$988	
Electric Situs	251,693,030	245,856,831	5,836,199	\$224,173	\$224,173	
Electric Transmission	233,842,763	228,182,439	5,660,324	\$193,811	\$193,811	
Twnsnd-Garr 500 A&B	5,450,629	7,445,868	(1,995,239)	(\$65,733)	(\$65,733)	
Gas Distribution	180,604,866	173,810,542	6,794,324	\$286,735	\$286,735	
Gas Situs	48,276,147	47,976,392	299,755	\$11,725		\$11,725
Gas Transmission	145,989,876	136,849,674	9,140,202	\$334,512		\$334,512
Storage Lines	30,268,413	28,881,733	1,386,680	\$46,219		\$46,219
				\$2,306,275	\$1,885,251	\$421,023

05OC - 2005 ORIGINAL COST

04OC - 2004 ORIGINAL COST

DIFF - DIFFERENCE

INC TAX - INCREMENTAL TAX

12. In its application, NWE included tribal taxes and fees of \$91,092 for electric and \$286,421 for natural gas. The Commission determines that tribal taxes are not local taxes within the meaning of the statute. A local tax is levied by a local government unit. As the Wisconsin Supreme Court stated:

But to determine whether a tax is to be classified as a state or a local tax, one must look to the entity which directly levies the tax, and which in turn directly provides government benefits therefore. If that entity is the state, it is a state tax. If that entity is a political subdivision of the state, it is a local tax.

Buse v. Smith, 247 N.W.2d 141, 152 (Wis. 1976).

In Montana a local government unit is a “city, county, town, unincorporated municipality or village, special taxing unit or district and any commission, board, bureau, or other office of the unit.” § 2-11-103(3), MCA. Tribal governments are not local governments. Therefore, tribal taxes or fees are not local taxes or fees. The Commission determines tribal taxes and fees should be disallowed.

NWE, as in Docket D2004.11.186, made no adjustment for the deductibility of federal and state and local income taxes. NWE asserted that it is entitled to collect 100% of the increased taxes. This is the third docket to come before the Commission under § 69-3-308, MCA. In the first two dockets, the Commission required the utility to reduce its tax adjustment by the marginal tax rate. *See In the Matter of Energy West Montana, Application for Automatic Rate Adjustment and Tracking for Taxes and Fees*, Docket No. D2003.12.165, Order 6556 (April 16, 2004) and *In the Matter of the Application of NorthWestern Energy for Automatic Rate Adjustment and Tracking for Taxes and Fees*, Docket No. D2004.11.186, Order No. 6621a (November 2, 2005 (petition for judicial review filed January 17, 2006)). The Commission determines that this is the correct interpretation of § 69-3-308(2)(a)(i)(A), MCA. The Commission will allow NWE to establish rates to collect the gross tax increase on regulated assets and activities reduced by 39.39% (marginal income tax rate).

Transmission Adjustment

13. Of the total state and local taxes for electric service, in excess of \$9.5 million is attributable to transmission assets. NWE collects revenue for transmission from Commission-approved tariffs and from a FERC-approved open access transmission tariffs (OATT.) The Commission offsets the FERC tariff revenue against the revenue requirement in general rate case dockets. In Docket D2000.8.113, Montana Power (the predecessor company to NWE) had an offset of approximately \$3 million. In 2000, MPC received \$31.9 million on 4.4 million megawatt hours for transmission for others. In 2004, NWE received \$34.2 million on 7.7 million megawatt hours. By way of comparison, from 1999 to 2005, transmission under Commission-approved tariffs has grown modestly from 4.8 million megawatt hours to 5.3 million megawatt hours.

14. A system that allocates all of the transmission tax and fee increase to Montana, Commission-regulated ratepayers is inherently inequitable. NWE argues that the revenue offset in Docket D2000.8.113 is a sufficient mechanism. However, as NWE imposed charges for the transmission tax and fee increase only on Montana ratepayers, those ratepayers are subsidizing customers in other states. As a result, rates under the OATT are kept artificially low. This also applies to choice customers to the extent they pay rates under the OATT rather than Commission-approved tariffs.

15. The record in this docket is not sufficient to allocate properly the increased transmission taxes to all the users of the transmission system.

16. Based on the evidence in the record of this docket, the Commission estimates that the incremental tax increase on transmission assets is \$1,724,667. The estimate is based on NWE's response to PSC Data Request PSC-001 and is derived as follows:

	2005	2005	2001	2001	2000	2000	Estimated
Code	Description	Tax	Description	Tax	Description	Tax	Increase
EK	Other Transmission	\$426,366	Div 39 Other Trans	\$336,880			\$426,366
EO	Col-Bdvw 500 A&B	\$510,038	Col-Bdvw 500 A&B	\$658,952	Colstrip-Bdvw 500kv A&B	\$480,531	\$29,507
ER	Bdvw-Twnsnd 500 A&B	\$432,174	Bdvw-Twnsnd 500 A&B	\$638,855	Bdvw-Twnsnd 500 KV A&B	\$390,877	\$41,297
ET	Electric Transmission	\$8,006,822	Electric Transmission	\$6,231,902	Electric Transmission	\$6,784,322	\$1,222,500
EU	Twnsnd-Garr 500 A&B	<u>\$179,571</u>	Twnsnd-Garr 500 A&B	\$340,396	Twnsns-Garrison 500kv A&B	<u>\$174,574</u>	<u>\$4,997</u>
Total		\$9,554,971				\$7,830,304	\$1,724,667

17. Allocation based on the evidence in this docket has inherent flaws. For an allocation based on regulated and unregulated transmission revenues, the years did not match and the regulated revenue captured transmission demand charges but not volume charges under a number of tariffs. For an allocation based on regulated and unregulated transmission volumes, certain schedules did not capture any volumes under the regulated volume, and others used energy distribution volume to estimate the transmission volume. The Commission determines that the record for the allocation of transmission between regulated and unregulated customers is sufficiently lacking to make a decision as to the proper allocation impractical.

18. Although a portion of the transmission taxes are attributable to regulated customers, the lack of an adequate record compels the Commission to disallow the tax increases associated with transmission assets. NWE has failed to meet its burden of demonstrating that it is entitled to collect the increase through regulated rates.

19. The Commission reserves the issue of allocation of transmission tax increases for further examination and development of an adequate record. Upon a proper showing, NWE will be allowed recovery for the portion that is attributable to regulated customers from January 1, 2006. The Commission will establish a procedural schedule for this reserved issue after NWE makes the filing required in this Order.

20. The total recovery for taxes attributable to regulated electrical is \$5,592,912 as shown in the table below:

Total Rate Change Computation for Electric Regulated Assets			
	Requested	Adjustment	Allowed
Property Tax	\$46,772,353		
WET	<u>\$1,304,744</u>		
Total	\$48,077,097		
ADJUSTMENTS:			
Transmission Tax Increase		(\$1,724,667)	
Incremental Tax for Unexplained Cost Increase		(\$1,749,043)	
Adjusted Total Taxes	\$48,077,097	<u>(\$3,564,802)</u>	\$44,512,295
Estimated Revenue	\$41,937,602		\$41,937,602
Difference	\$6,139,495	(\$3,564,802)	\$2,574,693
Income Tax Effect (39.39%)	\$0	(\$1,014,172)	(\$1,014,172)
2006 Taxes & Fees Rate Change Component	\$6,139,495		\$1,560,521
2005 Deferred Balance as requested	\$6,844,297		
Income Tax Effect (39.39%)	\$0	<u>(\$2,811,906)</u>	
2005 Deferred Balance as allowed			\$4,032,391
Total Rate Change	\$12,983,792	(\$7,390,880)	\$5,592,912

21. The total recovery for taxes attributable to regulated gas is \$2,706,128 as shown in the table below:

Total Rate Change Computation for Natural Gas Regulated Assets			
	Requested	Adjustments	Allowed
2006 Natural Gas Property Tax	\$17,496,856		
Adjustments:			
Incremental Tax for Unexplained Cost Increase		(\$421,023)	
Tribal Taxes & Fees		<u>(\$286,421)</u>	
Adjusted Total Taxes	\$17,496,856	(\$707,444)	\$16,789,412
Estimated Revenue	<u>\$14,844,068</u>	(\$707,444)	<u>\$14,844,068</u>
Difference	\$2,652,788	(\$707,444)	\$1,945,344
Income Tax Effect (39.39%)	<u>\$0</u>	(\$766,271)	<u>(\$766,271)</u>
2006 Taxes & Fees Rate Change Component			\$1,179,073
2005 Deferred Balance	\$2,554,195		
Income Tax Effect (39.39%)	\$0	<u>(\$1,027,140)</u>	
Adjusted Deferred Balance			\$1,527,055
Total Rate Change	\$5,206,983	(\$2,500,855)	\$2,706,128

Conclusions of Law

1. NWE provides electric and natural gas service within the State of Montana and as such in a “public utility” within the meaning of § 69-3-101, MCA.
2. The Commission properly exercises jurisdiction over NWE’s Montana rates, service and operations pursuant to Title 69, Chapter 3, MCA.
3. The Commission is required by § 69-8-308, MCA to allow a public utility to file rate schedules to recover and track Montana state and local taxes and fees.
4. Adjustments for increased Montana state and local taxes and fees must be reduced to account for the deductibility of state and local taxes and fees in calculating federal and state income tax liability.
5. For all issues except the allocation of increased transmission taxes, this is a final order.

Order

6. NorthWestern Energy is authorized to permanently increase rates and charges in Electric Tariff Schedules REDS-1, GSEDS-1, GSEDS-2, ISEDS-1 and ELDS-1 from the rates authorized in Order 6621a by a uniform percentage collecting \$5,592,912 annually for service provided on or after January 1, 2006.
7. NorthWestern Energy is authorized to permanently increase rates and charges in Natural Gas Tariff Schedules D-RG-1, D-GSG-1, D-RGCA-1, D-GSGCA-1, D-FTG-1, D-ITG-1, T-FUGC-1, T-FTG-1, T-ITG-1 and T-FSG-1 from the rates authorized in Order 6621a by a uniform percentage to collect \$2,706,128 annually for service provided on or after January 1, 2006.
8. NorthWestern Energy must file tariffs to implement the authority granted in this Order.

9. NorthWestern Energy must comply with all findings of fact and conclusions of law in this Order.

10. NorthWestern must separately account for any revenue collected for service provided on or after January 1, 2006 from the imposition of rates in excess of those authorized by this order. The disposition of any such revenue will be determined in the reserved issue proceeding initiated in paragraph 10, *infra*.

11. The issue of allocation of increased transmission taxes to Montana regulated ratepayers is reserved for further consideration. NWE is ordered to separately account for increased transmission taxes incurred in 2006. NWE is further ordered to file testimony and exhibits addressing this issue on or before March 20, 2006.

DONE IN OPEN SESSION at Helena, Montana on the 8th day of February, 2006 by a vote of 5 to 0.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION

Greg Jergeson, Chairman

Brad Molnar, Vice Chairman

Doug Mood, Commissioner

Robert H. Raney, Commissioner

Thomas J. Schneider, Commissioner

ATTEST:

Connie Jones
Commission Secretary

(SEAL)

NOTE: Any interested party may request the Commission to reconsider this decision. A motion to reconsider must be filed within ten (10) days. See ARM 38.2.4806.